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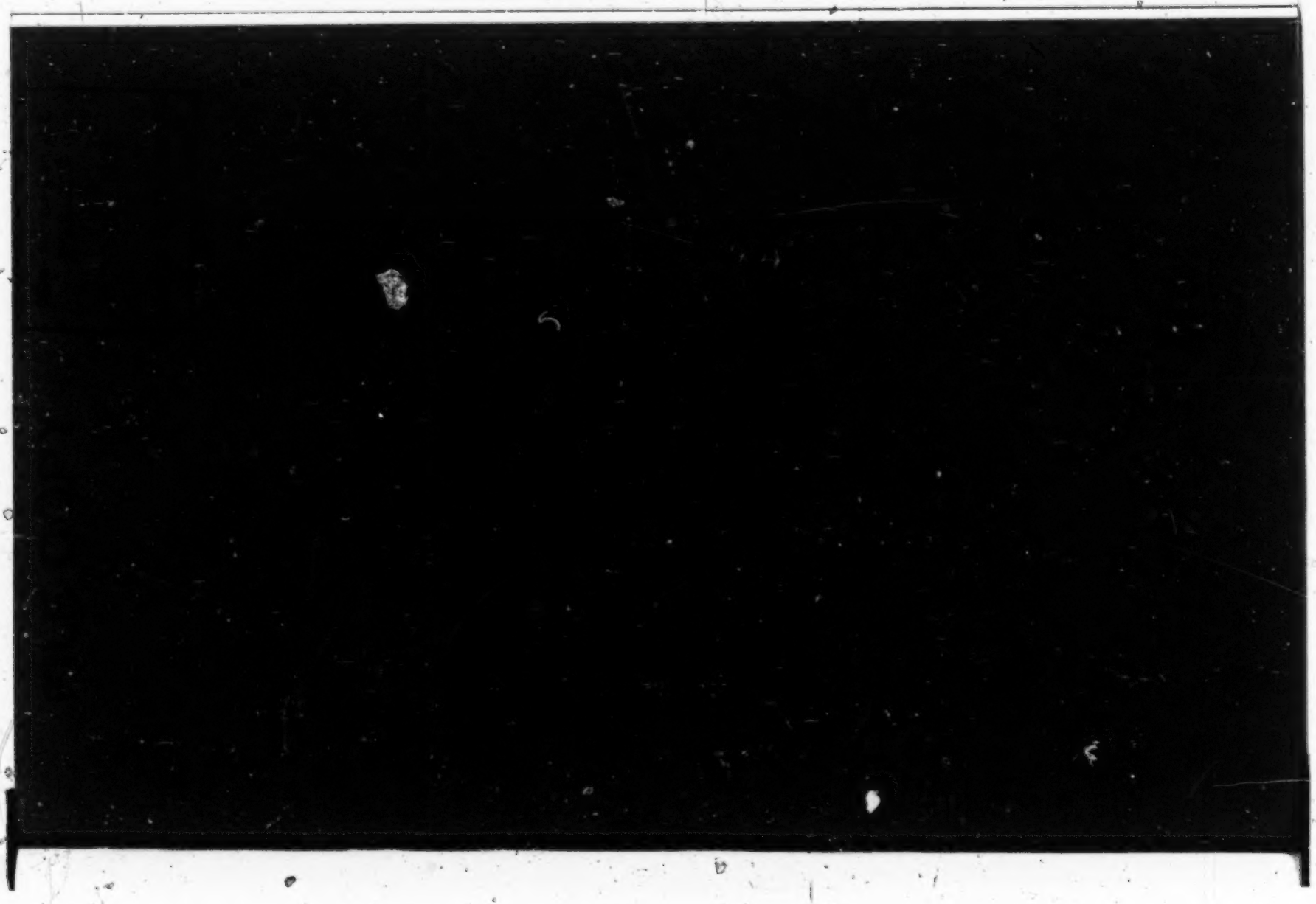

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 627

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILLIAM FLACCUS OAK LEATHER COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on September 13, 1940.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 5) is unreported. The opinion of the Circuit Court of Appeals (R. 17) is reported in 114 F. (2d) 783.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 13, 1940 (R. 23). The

jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the gain arising from insurance payments for loss by fire of certain property, owned by the taxpayer, is a gain from the "sale or exchange" of a capital asset which may enter into the computation, under Section 117 (d) of the Revenue Act of 1934, of the deduction allowable for losses sustained by the taxpayer from sales or exchanges of other capital assets.

STATUTE AND REGULATIONS INVOLVED

The relevant provisions of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 7–11.

STATEMENT

The pertinent facts, found by the Board of Tax Appeals (R. 6) to be as stipulated (R. 3–5), may be summarized as follows:

On or about September 25, 1935, a plant owned by the taxpayer at Buckhannon, West Virginia, was destroyed by fire. The buildings, machinery, equipment, and merchandise were all destroyed. During the taxable year 1935, the taxpayer received, as insurance compensation for its loss, the amount of $174,898, of which $101,765.50 was for merchandise and inventory destroyed and $73,132.50 for the buildings, machinery, and equipment.

Prior to the taxable year 1935, the buildings, machinery, and equipment had been completely depreciated on the books and records of the taxpayer for income-tax purposes. (R. 4.)

At no time during the taxable year 1935, nor at any time thereafter, did the taxpayer set up a replacement fund or expend any of the insurance proceeds so received in the acquisition of other property similar or related in services or use to the property as destroyed or in the acquisition of control of a corporation owning such other property. (R. 4.)

The taxpayer returned the $73,132.50, received as insurance on the buildings and machinery, as a capital gain for the year 1935. It reported other capital gain, on sales of securities, in the amount of $862.50, which is not here in issue, and capital losses in the amount of $76,767.62, likewise not in issue. Against its total capital loss reported of $76,767.62, it offset its total capital gain reported in the amount of $73,995, and thus reflected on its return a net capital loss of $2,772.62, of which it claimed $2,000 as allowable under Section 117 of the Revenue Act of 1934. (R. 5.)

The Commissioner eliminated from capital gain the amounts received by way of insurance on the ground that these amounts were ordinary income. He thus found the capital loss to be $75,967.62, of which $2,000 was allowed as a deduction, under the limitation provided by Section 117 (d) of the Reve-

nue Act of 1934, and increased the capital loss exclusion from $772.62 to $73,967.62 or an increased disallowance of capital loss in the amount of $73,195. The Commissioner then added the $73,132.50 received by way of insurance to ordinary income. (R. 5.)

The Board of Tax Appeals approved the determination of the Commissioner (R. 5–12). On appeal, to the Circuit Court of Appeals for the Third Circuit, the Board's decision was reversed (R. 17–21).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the gain arising from insurance payments for loss by fire of certain property, owned by the taxpayer, is a gain from the "sale or exchange" of a capital asset which may enter into the computation, under Section 117 (d) of the Revenue Act of 1934, of the deduction allowable for losses sustained by the taxpayer from sales or exchanges of other capital assets.

2. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below is in direct conflict with *Herder* v. *Helvering*, 106 F. (2d) 153 (App. D. C.), certiorari denied, 308 U. S. 617, rehearing denied, 308 U. S. 639. The opinion of the court below recognizes this conflict.

2. A related question is pending before this Court in *Helvering* v. *Hammel*, No. 49, and *Electro-*

Chemical Engraving Co., Inc. v. *Commissioner*, No. 62, October Term, 1940, in which cases the Government takes the position that the loss suffered from foreclosure sales is a loss from the "sale" of a capital asset.

3. The court below in *Commissioner* v. *Freihofer*, 102 F. (2d) 787, contrary to the position taken by the Government in the *Hammel* and *Electro-Chemical* cases, held that a loss resulting to the owner of land from the foreclosure of a mortgage lien was *not* a loss from a "sale or exchange" within the meaning of Section 117 of the Revenue Act of 1934, *infra*, p. 9. But in the present case, it held that Congress, in Section 112 of the Revenue Act of 1934, *infra*, p. 8, classified the involuntary conversion of property by destruction, together with other named involuntary methods of conversion, as a sale or exchange of property, and that the term "sale or exchange" should have the same meaning in Section 117 and in Section 112. Obviously, much confusion is likely to result as a consequence of the decision below. And since the question whether destruction of property, or theft or seizure of property, is a sale or exchange of such property, within the meaning of the capital gain and loss section of the Revenue Acts, is likely to recur frequently, it would be helpful in the administration of the revenue laws to have the issue clarified.

CONCLUSION

It is respectfully submitted that, for the foregoing reasons, this petition should be granted.

FRANCIS BIDDLE,
Solicitor General.

DECEMBER, 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23. [U. S. C., Title 26, Sec. 21.]

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes * * * gains or profits and income derived from any source whatever. * * *

* * * * * *

(e) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111. [U. S. C., Title 26, Sec. 22.]

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * * *

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * * *

[U. S. C., Title 26, Sec. 111.]

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

(1) *Property Held for Productive Use or Investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for Stock of Same Corporation.*—* * *

(3) *Stock for Stock on Reorganization.*—* * *

(4) *Same—Gain of Corporation.*—* * *

(5) *Transfer to Corporation Controlled by Transferor.*—* * *

(c) *Gain From Exchanges Not Solely in Kind.*—

* * * * * *

(d) *Same—Gain of Corporation.*—* * *

* * * * * *

(e) *Loss From Exchanges Not Solely in Kind.*—* * *

(f) *Involuntary Conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or in the threat or imminence thereof) is com-

pulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

* * * * * *

[U. S. C., Title 26, Sec. 112.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

* * * * * *

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

* * * * *

(f) *Retirement of Bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. [U. S. C., Title 26, Sec. 101.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 117–1. *Meaning of capital assets.*—The term "capital assets" includes all classes of property not specifically excluded by section 117 (b). The term is not limited to stocks and bonds nor to property held for more than two years. In determining whether property is a "capital asset," the period for which held is immaterial.

ART. 117–2. *Limitations on capital gains and capital losses.*— * * *

Section 117 (d) provides a limitation on deductions for capital losses affecting all taxpayers including corporations, that is, losses from sales or exchanges of capital assets shall be allowed as deductions only to the extent of $2,000 plus the gains from such sales and exchanges. However, in the case of certain banks or trust companies, this

limitation is subject to the modification provided in that section.

* * * * * *

ART. 117–4. *Application of section 117 generally.*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the permanent abandonment of the use of property (see article 23 (e)–3), or loss sustained as the result of corporate stock or debts becoming worthless.

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